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# In the Supreme Court of the United States

OCTOBER TERM, 1954

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No. —

COMMISSIONER OF INTERNAL REVENUE, PETITIONER

*v.*

B. H. SWANEY & SONS, INC., and SWANEY CONTRACTING COMPANY

---

**CONDITIONAL PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FOURTH CIRCUIT**

The Solicitor General, on behalf of the Commissioner of Internal Revenue, prays that a writ of certiorari issue to review the judgment of the Court of Appeals for the Fourth Circuit, entered in the above cause on April 9, 1954, but only in the event that a writ of certiorari is granted in *Gregory Run Coal Co.* v. *Commissioner, J. E. Vincent* v. *Commissioner, J. E. Vincent Co., Inc.* v. *Commissioner,* No. 194, this Term.

**OPINIONS BELOW**

The opinion of the Court of Appeals (App. 5a-29a)[1] is reported at 212 F. 2d 52. The memoran-

[1] "App." refers to the Appendix to this petition, pp. 1a-31a, *infra.*

dum opinion of the Tax Court (App. 1a-4a) is not officially reported.

JURISDICTION

The judgment of the Court of Appeals was entered on April 9, 1954. (App. 30a.) By order dated July 7, 1954, the time for filing a petition for a writ of certiorari was extended by Mr. Justice Burton to August 7, 1954. (App. 31a.) The jurisdiction of this Court is invoked under 28 U. S. C., Section 1254.

QUESTION PRESENTED

Whether the taxpayers acquired a depletable economic interest in certain coal deposits, under Sections 23(m) and 114(b) of the Internal Revenue Code, by virtue of certain contracts under which the taxpayers performed strip-mining operations.

STATUTE AND REGULATIONS INVOLVED

Internal Revenue Code:

> SECTION 23. DEDUCTIONS FROM GROSS INCOME.
>
> In computing net income there shall be allowed as deductions:
>
> * * * *
>
> (m) *Depletion.*—In the case of mines, oil and gas wells, other natural deposits, and timber, a reasonable allowance for depletion and for depreciation of improvements, according to the peculiar conditions in each case; * * *
>
> * * * *
>
> (26 U.S.C. 1952 ed., Sec. 23.)

SEC. 114. BASIS FOR DEPRECIATION AND DEPLETION.

* * * *

(b) *Basis for Depletion.*—

* * * *

(4) [as amended by Sec. 145, Revenue Act of 1942, c. 619, 56 Stat. 798, and Sec. 124, Revenue Act of 1943, c. 63, 58 Stat. 21]*Percentage Depletion for Coal* * * *

(A) *In General.*—The allowance for depletion under section 23(m) shall be, in the case of coal mines, 5 per centum, * * * of the gross income from the property during the taxable year, excluding from such gross income an amount equal to any rents or royalties paid or incurred by the taxpayer in respect of the property. Such allowance shall not exceed 50 per centum of the net income of the taxpayer (computed without allowance for depletion) from the property, * * *.

(B) *Definition of Gross Income From Property.*—As used in this paragraph the term "gross income from the property" means the gross income from mining. The term "mining", as used herein, shall be considered to include not merely the extraction of the ores or minerals from the ground but also the ordinary treatment processes normally applied by mine owners or operators in order to obtain the commercially marketable mineral

product or products. The term "ordinary treatment processes", as used herein, shall include the following: (i) In the case of coal—cleaning, breaking, sizing, and loading for shipment; * * *

* * * * *

(26 U.S.C. 1952 ed., Sec. 114.)

Treasury Regulations 111, promulgated under the Internal Revenue Code:

SEC. 29.23 (m)-1. DEPLETION OF MINES, OIL AND GAS WELLS, OTHER NATURAL DEPOSITS, AND TIMBER; DEPRECIATION OF IMPROVEMENTS.—Section 23(m) provides that there shall be allowed as a deduction in computing net income in the case of mines, oil and gas wells, other natural deposits, and timber, a reasonable allowance for depletion and for depreciation of improvements. Section 114 prescribes the bases upon which depreciation and depletion are to be allowed.

Under such provisions, the owner of an economic interest in mineral deposits or standing timber is allowed annual depletion deductions. An economic interest is possessed in every case in which the taxpayer has acquired, by investment, any interest in mineral in place or standing timber and secures, by any form of legal relationship, income derived from the severance and sale of the mineral or timber, to which he must look for a return of his capi-

tal. But a person who has no capital investment in the mineral deposit or standing timber does not possess an economic interest merely because, through a contractual relation to the owner, he possesses a mere economic advantage derived from production. Thus, an agreement between the owner of an economic interest and another entitling the latter to purchase the product upon production or to share in the net income derived from the interest of such owner does not convey a depletable economic interest.

* * * * *

STATEMENT

Petitions were brought by respondent corporations in the Tax Court under 26 U.S.C. 272(a)(1) and 1101 for redetermination of deficiencies determined by the Commissioner. The facts, which are not in dispute, may be summarized as follows:

On December 24, 1945, one J. E. Vincent [2] entered into a contract with respondent Swaney Contracting Company wherein he employed this corporate taxpayer to strip-mine coal on mining property he held by lease. Under the contract Vincent provided the sidetrack, the tipple and the men (paid by him) to operate them, and had complete charge

[2] Vincent is a petitioner, together with the J. E. Vincent Company, Inc. and Gregory Run Coal Company, in No. 194, this Term. As we explain more fully below, that petition, which we are opposing, necessitates this conditional petition to protect the revenue since, if petitioners prevail in No. 194, it follows that the judgments for respondents here must be reversed.

of the coal after it was loaded or dumped at the tipple. Swaney Contracting furnished the equipment and employees to mine and haul 25,000 tons of coal a month and bound itself to backfill and restore the land in accordance with the terms of the lease. Swaney Contracting agreed to secure the necessary bonds and mining permits required by the state and to maintain adequate public liability and property damage insurance for its operations. Vincent was to carry insurance on the tipple and sidetrack. It was expressly provided that in all respects Swaney Contracting was to operate as an individual contractor. It was to be paid for its services on the basis of the coal accepted and paid for by the Weaver Company, the sales agent of Vincent, at the rate of $2 per ton, but with provisions for the adjustment of the basic payment in the event of a change in the sales price of the coal. Vincent remained liable for the payment. The contract was not cancelable except on specified defaults by the parties or in the event that the sales price of the coal fell below $2.76 per ton. Vincent remained liable to pay the royalties due to the lessor under the leases.

Another stripping agreement was made on April 26, 1947, between Vincent and respondent B. H. Swaney & Sons, Inc. Swaney, Inc., was to strip, load and haul to a tipple operated by Vincent all the coal under the lease that was not being operated under another contract. The provisions of the agreement were similar to those in the contract between Vincent and Swaney Contracting, except

that the compensation to Swaney, Inc., was to be at the rate of $2.18 per ton. Provision was made for adjustment in this compensation in the event of changes in the sales price of the coal. Vincent had the option to cancel the contract if the price of the coal fell to a point where the operations were unprofitable to him.

Both of the Swaney companies carried out their agreements. The price of coal increased during the period of their operations. Each of them received compensation in excess of the base amount per ton specified in the contracts.

Vincent and his closely-held corporation, J. E. Vincent Company, Inc., both contended in the Tax Court that there was no transfer of a depletable interest to either of the Swaney companies under the contracts described above and hence that Vincent or Vincent, Inc., was entitled to the statutory depletion deduction for the amounts paid respondents. The Tax Court sustained these contentions. Subsequently the Swaney companies claimed the same depletion allowance before the Tax Court but were unable to persuade the court to abandon the position it had taken in the Vincent cases. On petitions and cross-petitions for review, both cases were reversed by the Court of Appeals, which held that there had been transfers of depletable interests to respondents, that respondents were accordingly entitled to depletion deductions, and that corresponding deductions by Vincent and Vincent, Inc., had been properly disallowed by the Commissioner.

REASONS FOR GRANTING THE WRIT

This is a companion case to *Gregory Run Coal Co.* v. *Commissioner, etc.,* No. 194, this Term, in which a petition for certiorari was filed July 6, 1954, by the taxpayers. These cases involve a common issue and were consolidated for argument before the Court of Appeals, which wrote a single opinion disposing of them. The taxpayers in these cases are rival claimants to the allowable depletion deduction on the production from certain coal properties located in Lambert's Run, West Virginia. The Court of Appeals, reversing the Tax Court, held that J. E. Vincent, holder of the leases, was not entitled to the deduction, and that the respondent Swaney interests, producers of the coal, were entitled to this benefit on the same properties. While technically the decision of the Court of Appeals in the instant case is adverse to the Commissioner, that decision followed as a consequence of the Commissioners' success on his own appeals in the *Gregory Run* and *Vincent* cases, and is, therefore, in complete accord with the position taken by the Commissioner on the depletion issue.

We believe that the Court of Appeals was correct in its application of the "economic interest" test, laid down in *Burton-Sutton Oil Co.* v. *Commissioner,* 328 U.S. 25, to the facts of this case. There is no material difference between fixing the compensation of the producer by a specified percentage of the proceeds of the product, as in *Burton-Sutton,* and fixing the compensation of the producer by the selling price of the coal, adjustible to changes in

the market, as in the instant case. In both cases alike the producer is entitled to a depletion allowance. The Court of Appeals properly noted that the depletion herein was dependent upon production and that the possibility of profit from the use by the operator of his rights over production was dependent solely upon the extraction and sale of the product giving him an economic interest therein. (App. 28a.)

The Commissioner is opposing certiorari in the *Gregory Run* case. However, it is necessary for the Commissioner to file this conditional petition in the instant case to protect the revenue, since both taxpayers are not entitled to the same depletion allowance. Section 114(b)(4) of the Internal Revenue Code, *supra,* pp. 3-4; *Kirby Petroleum Co.* v. *Commissioner,* 326 U.S. 599, 604; *Helvering* v. *Twin Bell Syndicate,* 293 U.S. 312, 320-321; *Anderson* v. *Helvering,* 310 U.S. 404, 407. Were this Court to grant the *Gregory Run* petition and subsequently hold for the taxpayer on the depletion issue without taking the instant case also, the statutory depletion allowance could not be allocated between the contracting parties in accordance with the statute. Rather, the Vincent and the Swaney claimants would both obtain depletion allowances on the same gross income, to the detriment of the federal revenue.

CONCLUSION

For the foregoing reasons, it is respectfully submitted that this conditional petition for a write of certiorari should be granted if, but only if, a writ is granted in the companion *Gregory Run* cases, No. 194, this Term, in respect to the depletion issue.

SIMON E. SOBELOFF,
*Solicitor General.*

AUGUST, 1954.